

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE
MINUTES OF THE NOVEMBER 18, 2009 PENSION BOARD MEETING

1. Call to Order

Chairman Dr. Dean Roepke called the meeting to order at 8:48 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present:

Linda Bedford (Vice Chair)
Keith Garland
Mickey Maier
Jeffrey Mawicke
Dr. Sarah Peck
Dr. Dean Roepke (Chairman)

Members Excused:

Donald Cohen
Marilyn Mayr
Guy Stuller

Others Present:

David Arena, Director of Employee Benefits, Department of Administrative Services
Mark Grady, Principal Assistant Corporation Counsel
Gerald Schroeder, ERS Manager
Dale Yerkes, Assistant to the Fiscal Officer
Monique Taylor, ERS Clerical Specialist
Bess Frank, Ad Hoc Oversight Committee
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Brian Wrubel, Marquette Associates, Inc.
Ray Caprio, Marquette Associates, Inc.
Larry Langer, Buck Consultants
Matt D'Attilio, Reinhart Partners, Inc.
Daniel Deter, Reinhart Partners, Inc.
MaryAnn Grimes, Appellant
Jacqueline Kleckley, Disability Appellant
Steve Schultze, Reporter, *Milwaukee Journal Sentinel*

3. Chairman's Report

The Chairman reported on the International Foundation of Employee Benefit Plan's annual conference. He indicated that investments were a heavily presented topic and the presenters discussed what they had learned from the down market. He noted that he received a notice for the National Conference on Public

Employee Retirement System ("NCPERS") legislative conference in February 2010. He suggested that a Board member attend.

The Chairman discussed the meeting schedule for 2010 and requested comments. Mr. Grady pointed out that two Investment Committee meetings fall on holidays and will need to be rescheduled.

4. Minutes of the October 21, 2009 Pension Board Meeting

The Pension Board reviewed the minutes of the October 21, 2009 Pension Board meeting.

The Pension Board unanimously approved the minutes of the October 21, 2009 Pension Board meeting. Motion by Mr. Maier, seconded by Mr. Mawicke.

5. Reports of Employee Benefits Director, ERS Manager and Assistant Fiscal Officer

(a) Retirements Granted, October

Mr. Schroeder presented the Retirements Granted Report for October 2009. He reported that 21 retirements were granted in October, noting that 10 retirees elected back DROPs, in amounts totaling \$1,156,135.

(b) ERS Monthly Activities Report, October

Mr. Schroeder indicated that there were 7,395 retirees at the end of October, and that ERS paid out \$12,663,267 in benefit payments in October.

Mr. Schroeder reported that the Retirement Office staff has received a substantial amount of training in the past 30 days, including a third test on their V-3 skills. He indicated that the upcoming V-3 System upgrade will improve navigation for users.

Mr. Schroeder stated that ERS signed the contract with VoteNet for the upcoming employee and retiree elections. He advised that he will notify the Board of all information regarding the elections.

In response to a question from the Chairman, Mr. Schroeder stated that the divorce item on the activities report merely reflects the change of the participant's status from married to divorced.

(c) Cash Flow Report

Mr. Yerkes presented ERS's cash flow report. He estimated that ERS will need \$85 million in 2010 to fund ERS's benefit payments and expenses. He indicated that Marquette will present later on the source of the \$85 million.

Mr. Yerkes stated he met with Baker Tilly in October to discuss Baker Tilly's concerns and the 2010 audit schedule. He noted that Baker Tilly is concerned with the proper functioning of the new software system and the new futures program. He stated that he had a conference call with Baker Tilly and the Bank of New York Mellon to discuss the futures program. He noted that there were still some open issues and Marquette will be on the next call to clarify any remaining issues. He commented that Baker Tilly will perform its pre-audit work in January and conduct the audit in April.

Mr. Yerkes reviewed the 2010 ERS budget, which he previously reviewed at the Audit Committee meeting. Responding to a question raised, he indicated that FICA tax equals 7.65% of payroll, while other benefits are charged based on head count. Mr. Grady stated that the budget will be covered at the December Pension Board meeting.

Mr. Yerkes reported that he met with Mr. Manske, representatives of the County's budget committee and ERS's actuary to discuss the time frame regarding the preparation of ERS's annual contribution request. In response to a question from the Chairman, Mr. Arena stated that preparing the contribution request earlier will help the County Board with its budgeting process. Mr. Yerkes indicated that ERS will prepare its request one month earlier than normal in 2010. He stated that the County may ask ERS to submit its contribution request several months earlier starting in 2011. He noted that he will report to the Board for review and approval, if and when the County makes such a request.

6. Investments

(a) Reinhart Partners, Inc.

Messrs. D'Attilio and Deter distributed a report and described Reinhart Partners, Inc.'s management of its mid-cap growth equity investment strategy. Mr. D'Attilio reported that Reinhart Partners uses performance-based goals for compensation in order to ensure Reinhart Partners' goals are aligned with its clients' goals. He stated that Reinhart Partners is 100% employee-owned with 12 owners. He reviewed the composition of the mid cap equity management team.

Mr. D'Attilio explained Reinhart Partners' investment process and philosophy. He stated that Reinhart Partners is a bit unique in that it does not utilize the funnel approach used by most managers, which results in a list of the same companies for each client and often the same list for many managers. He indicated that Reinhart Partners looks for industries with a decrease in supply or an increase in demand. He commented that Reinhart Partners examines where a company's future cash will come from in conjunction with its reported figures. He pointed out that economists, analysts and investment managers screen on trailing figures, unlike Reinhart Partners which focuses on emerging trends.

Mr. D'Attilio discussed Reinhart Partners' life cycle investment philosophy and provided the example of the life cycle of the movie theater industry. He stated that the marketplace is efficient, which leads to repetitive industry cycles. He commented that Reinhart Partners finds industries and companies where the demand exceeds the supply or there is at least equilibrium.

Dr. Peck asked whether Reinhart Partners follows the same dollar flow trail into specific investments by the investment community. Mr. D'Attilio stated that there are more buy recommendations later in the investment cycle and that is the time to consider possibly selling an investment. He commented that new initial public offerings or secondary offerings by existing competitors are red or yellow flags. He discussed how the expectations in the solar industry became unreasonable when the industry expanded.

In response to a question, Mr. D'Attilio stated that the mid cap sector has been very good for the past 15 years and has had a good run recently. He commented that large international companies are cheaper and more stable right now, which makes mid cap not as attractive as it was in March. He pointed out that Reinhart Partners tries to find industries and companies where there is little interest, but where there should be more interest. He explained how Reinhart Partners determines what stage an industry is in its lifecycle. He reviewed the lifecycle of the cement industry. He noted that profit margins generally increase before sales growth.

Mr. D'Attilio presented Reinhart Partners' views on the status of the economy. He discussed the leverage of U.S. debt to U.S. GDP. He commented that interest costs are damaging to the long-term growth of the economy. He commented that Reinhart Partners agrees that stimulus is needed and that the U.S. must address the debt problem on an individual, company, state and federal level. He pointed out that banks are not lending at a high enough level because of the credit problems they experienced.

Mr. D'Attilio stated that the debt of many countries, including the United Kingdom, are being downgraded due to their high debt level. He indicated that there has been \$12.5 trillion distributed by governments worldwide in an effort to stimulate a successful worldwide economy. He reported that the falling value of the dollar helps U.S. exports. He noted that there is a large sum of uninvested cash sitting on the sidelines because some individuals are completely out of equities and some companies have not yet reinvested.

Mr. D'Attilio reported that the U.S. GDP was \$14.2 trillion in 2008 and the total household debt was \$13.8. He explained that the debt will prevent consumers from spending, so the growth will have to come from the federal and state level. He also stated that retail and restaurants are the most competitive businesses in the U.S.

Mr. D'Attilio stated that ERS's portfolio and the benchmark were down 4% in October, which was the first big drop off since the March rally. He noted that Reinhart Partners should beat its benchmark long term. He indicated the Reinhart Partners is not as aggressive as its benchmark, the Russell Mid Cap Growth Index. He pointed out that Reinhart Partners is more conservative and has beat its benchmark over the long term because Reinhart Partners retains more of its assets in down markets.

In response to a question from Mr. Maier, Mr. D'Attilio stated that he will provide the Pension Board with the quadrant ERS will be in over the next 3-5 years. Mr. D'Attilio indicated that Reinhart Partners' standard deviation is generally in the top quartile of mid cap managers. In response to a follow-up question from Mr. Maier, Mr. D'Attilio reported that Reinhart Partners has an 80% upside capture rate and a 70% downside capture rate, which is very good compared to its peers and benchmark. Mr. D'Attilio pointed out that the Russell Mid Cap Growth Index is a volatile index.

Mr. D'Attilio commented the Reinhart Partners believes that the economy has recovered from its bottom and that the government is doing the right things to stimulate the economy. He noted that U.S. economy is in a gestational period and the main question is whether the economy can sustain growth with the amount of leverage the U.S. has as a nation.

(b) Marquette Associates, Inc. Report

Mr. Caprio provided an update on the markets. He indicated that in the fixed income environment there has been a huge reversal from government bonds to the higher returns of corporate bonds and lower quality bonds. He reported that CCC bonds are up 79% year-to-date. He stated that there has

been a significant amount of government intervention, with the government buying government bonds -- which creates demand in other areas.

Mr. Wrubel noted that ten-year government and corporate bonds are comparable in yield, but there are wild fluctuations in the short term with corporate bonds. Mr. Caprio reported that there has been a bit of correction in the equity market but not a true correction.

Mr. Wrubel stated that ERS had approximately \$1.74 billion in assets at the end of October. He indicated that bonds have done relatively well year-to-date, and equities have also done well, especially mid cap growth. He noted that the investment sectors with the biggest sell off in 2008 have generally had the largest recovery so far this year. He pointed out that ERS is up 14.3% for the year-to-date.

Mr. Wrubel reviewed the asset allocation by asset class, with and without the pension obligation bond funds included in the allocation. He discussed ERS's investment manager performance. He commented that some of the international investment managers trailed their benchmarks and Marquette will revisit their performance in the fourth quarter performance report. He noted that the Loomis high-yield strategy is up 45.6% for the year-to-date and has outperformed the benchmark over the ten-year long-term time period. He indicated that the investment of the pension obligation bond funds are up 15.4% since mid-April. In response to a question from the Chairman, Mr. Wrubel discussed how ERS will get out of REITs.

Mr. Caprio stated that the Investment Committee discussed how ERS will fund future cash flow requests and new asset class commitments, which are currently being paid out of the pension obligation bond funds. He indicated that Marquette recommends discontinuing the auto-rebalancing of the cash overlay program, which BNYM has been rebalancing on a quarterly basis. He noted that Marquette recommends paying benefits out of the international equity and domestic equity allocations of the pension obligation bond funds.

In response to a question from Ms. Riley, Dr. Peck stated that Marquette will be rebalancing the portfolio by pulling cash from specific allocations of the pension obligation bond funds. Mr. Maier commented that this natural rebalancing of the portfolio costs less than liquidating managers' portfolios.

Mr. Caprio stated that Marquette also recommends unwinding the Loomis Sayles high-yield portfolio by \$20 million per month and transitioning those funds to the JPMorgan fixed income portfolio. He noted that the Pension Board could determine the desired asset transfer in December.

Mr. Caprio reviewed the recently completed transitions and the status of the in-process transfers. He discussed the timeline for the issuance of the RFPs for investment managers. He noted that the timeline is a working document that is constantly being updated.

Mr. Caprio reviewed the potential sources for rebalancing into the JPMorgan fixed income portfolio. He indicated the funds could come from the international equity futures portion of the cash overlay program or from the Loomis Sayles high-yield portfolio. In response to a question from Dr. Peck, Mr. Caprio stated that the transfer of the international equity futures fund helps with the overall rebalancing of the fund. In response to a question from Mr. Garland, Mr. Caprio stated that the money is being allocated to JPMorgan as a part of the overall rebalancing of the fund.

The Pension Board unanimously approved Marquette's recommendation to discontinue the automatic quarterly rebalancing of the cash overlay program managed by BNYM-Beta Management. Motion by Dr. Peck, seconded by Mr. Maier. Motion by Dr. Peck, seconded by Mr. Maier.

The Pension Board unanimously approved Marquette's recommendation to make a one-time transfer of \$20 million from the international equity cash futures overlay allocation to the JPMorgan fixed income portfolio. Marquette will revisit the futures weighting monthly and recommend to the Board which bucket to rebalance out of, if need be.

The Chairman stated that all manager solicitations and sales pitches have been directed to Marquette. Mr. Wrubel stated that Marquette has developed an information gathering process for manager solicitations. He indicated that Marquette requests information on the organization and if the organization has potential, Marquette sends the manager a more detailed request for information. After reviewing the information, Marquette either lets the manager know if it is inappropriate for ERS' portfolio or conducts additional due diligence if it may be appropriate. Mr. Grady suggested that the Investment Committee develop a practice or policy for dealing with investment manager cold calls.

(c) Investment Committee Report

Because he chaired the last meeting in Dr. Peck's absence, Mr. Maier presented the Investment Committee report. He indicated that long/short education was deferred to a later meeting. He noted that the committee also discussed the potential termination of the Loomis Sayles core strategy.

Mr. Maier commented that Loomis Sayles is trying to be opportunistic by adding return through additional risk. He stated that the Investment Committee members were tied, with two votes to transition out of the Loomis Sayles core investment and take the equity risks elsewhere and two votes to continue to retain the Loomis core strategy because Loomis has performed well.

Mr. Caprio reviewed the amount of funds ERS can allocate to fixed income under its policy, which is a little over \$600 million. Mr. Wrubel pointed out that Loomis is core plus, not core, but noted that the Pension Board could amend its investment guidelines.

In response to a question from Mr. Mawicke, Mr. Caprio stated that the Loomis Sayles core strategy employs an absolute return strategy, which takes on more risk, especially in currency. Mr. Mawicke commented that he favored retaining a 5-6% allocation to the Loomis Sayles core strategy because he believes it creates diversity in the portfolio, especially in light of the concerns over the value of the dollar over the next 5-10 years. Mr. Wrubel stated that the portfolio is or will be diversified against the dollar through ERS's international and infrastructure investments.

In response to a question from Ms. Bedford, Mr. Grady stated that 32% is allocated to fixed income, which can be allocated among any number of fixed income managers. The Chairman pointed out that JPMorgan's management fees are lower compared to Loomis Sayles if more funds are allocated to JPMorgan on a relative basis. He noted that the allocation away from Loomis is not based on performance, but on ERS's future asset allocation plan. Mr. Wrubel stated that ERS can be more conservative on its fixed income investments and take more risks in other areas of the portfolio. Mr. Caprio noted that ERS would retain more liquidity by transferring out of the Loomis Sayles core strategy.

Mr. Maier suggested deferring the Loomis discussion until the next meeting. He indicated that the Board needs more members discussing this issue in order to gain a true consensus of the Board. The Chairman stated the Loomis discussion will be resumed at the December Pension Board meeting.

Mr. Wrubel stated that he likes Loomis' returns but dislikes the higher risk exposure because of the high correlation to equities. He pointed out that the Loomis core portfolio captured 152% of the down market, which is bad, and 145% of the up market, which is good. Mr. Mawicke commented that an investor is not forced to sell a bond at a loss unless the investor needs

liquidity. Mr. Garland requested that Marquette provide comparisons of Loomis against its benchmark.

7. Audit Committee Report

Dr. Roepke presented the Audit Committee report on behalf of Mr. Stuller. He reported that the Audit Committee continued its ongoing discussion of the legal portability of pensions. He noted that the Audit Committee reviewed what occurs when a beneficiary predeceases a retiree and whether a member may name a new beneficiary. He indicated that Mr. Grady will draft an e-mail to the actuary regarding the cost impact of allowing a retiree to designate a new beneficiary if the beneficiary predeceases the retiree.

Dr. Roepke stated that the Audit Committee concluded that Rule 713(b) should be eliminated for clarity purposes. Mr. Grady explained that Rule 713(b) is being eliminated because the Pension Board adopted an 8.0% interest rate as the rate of return and the assumed rate of return for back DROPs.

The Pension Board unanimously agreed to remove Rule 713(b) from the ERS Rules to clarify the interest rate used to calculate back DROPs. Motion by Mr. Maier, seconded by Ms. Bedford.

Dr. Roepke pointed out that the Audit Committee also previewed the 2010 ERS budget.

8. Administrative Matters

The Chairman indicated that it would be beneficial for a Board member to attend the NCPERS legislative update in February 2010.

9. Mary Ann Grimes Claim Appeal

Ms. Bedford moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(g), with regard to item 9 for the purpose of the Board receiving oral or written advice from legal counsel concerning strategy to be adopted with respect to pending or possible litigation. At the conclusion of the closed session, the Board may reconvene in open session to take whatever actions it may deem necessary concerning these matters.

The Pension Board voted by roll call vote 6-0, to enter into closed session to discuss agenda item 9. Motion by Ms. Bedford, seconded by Dr. Peck.

Mr. Grady removed himself from the meeting for discussion of item 9 during closed session.

The Pension Board discussed Ms. Grimes' claim appeal in closed session.

Upon returning to open session, the Pension Board unanimously granted Ms. Grimes' claim appeal: Ms. Grimes shall select payment of her benefit in one of the available forms following recalculation of each of the forms of benefit available to her. Motion by Mr. Mawicke, seconded by Mr. Maier.

10. Lynn Marks Overpayment Appeal

Ms. Bedford moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(g), with regard to items 10, 11, 12, 13 and 14 for the purpose of the Board receiving oral or written advice from legal counsel concerning strategy to be adopted with respect to pending or possible litigation. At the conclusion of the closed session, the Board may reconvene in open session to take whatever actions it may deem necessary concerning these matters.

The Pension Board voted by roll call vote 6-0, to enter into closed session to discuss agenda items 10, 11, 12 and 13 and 14. Motion by Ms. Bedford, seconded by Dr. Peck.

The Pension Board took no action on this item.

11. Disabilities

(a) Applications

(i) Jan Bergstrom – ODR

After reviewing and discussing the Medical Board's report in closed session, upon returning to open session, the Pension Board unanimously approved Ms. Bergstrom's ordinary disability application based upon the recommendation of the Medical Board. Motion by Dr. Peck, seconded by Ms. Bedford.

(ii) Delores Hughes – ADR

After reviewing and discussing the Medical Board's report in closed session, upon returning to open session, the Pension Board unanimously denied Ms. Hughes' accidental disability application based upon the recommendation of the Medical Board. Motion by Dr. Peck, seconded by Ms. Bedford.

(iii) Pamela Jones – ODR

After reviewing and discussing the Medical Board's report in closed session, upon returning to open session, the Pension Board unanimously approved Ms. Jones' application for an accidental disability pension based on the Medical Board's report. The Pension Board withheld a decision on granting an ordinary disability pension until a later meeting and authorized the retention of a rheumatologist to provide a specialist exam. Motion by Mr. Mawicke, seconded by Dr. Peck.

(iv) Jacqueline Kleckley – ODR

Upon returning to open session, the Chairman indicated that the Pension Board decided to lay this item over until the December Pension Board meeting to request a review of all available medical records by the Medical Board.

(b) Request for Suspension Under Rule 1010

(i) James Paradinovich – ADR

Upon returning to open session, the Pension Board unanimously agreed to suspend Mr. Paradinovich's benefits under Rule 1010 until Mr. Paradinovich provides the Retirement Office the required information under Rule 1010. Motion by Mr. Mawicke, seconded by Ms. Bedford.

12. Pending Litigation

The Pension Board discussed its pending litigation in closed session.

(a) Mark Ryan, et al. v. Pension Bd.

The Pension Board took no action on this item.

13. Report on Special Investigation

The Pension Board took no action on this item.

14. Report on Compliance Review

The Pension Board took no action on this item.

15. Adjournment

The meeting adjourned at 1:15 p.m.

Submitted by Steven D. Huff,
Secretary of the Pension Board

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